

**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**NASHVILLE, TENNESSEE**

**August 13, 1999**

**IN RE: APPLICATION OF UNITED )  
CITIES GAS COMPANY TO )  
ESTABLISH AN EXPERIMENTAL ) DOCKET NO. 97-01364  
PERFORMANCE BASED )  
RATEMAKING MECHANISM )**

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**ORDER DENYING UNITED CITIES GAS COMPANY'S  
PETITION FOR RECONSIDERATION OF  
THE AUTHORITY'S FINAL ORDER ON PHASE ONE**

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This matter came before the Tennessee Regulatory Authority ("Authority") at a regularly scheduled Authority Conference held on February 16, 1999, upon the Petition for Reconsideration filed by the United Cities Gas Company ("United Cities" or "the Company"). On January 14, 1999, the Authority issued its Final Order on Phase One of the Experimental Performance Based Ratemaking Mechanism (hereafter "PBR mechanism") of United Cities. On January 22, 1999, United Cities filed a Petition for Reconsideration of one of the fifteen decisions which were rendered by the Directors in Phase One. On February 3, 1999, the Consumer Advocate Division, Office of the Tennessee Attorney General ("Consumer Advocate") filed a Reply to the Petition for Reconsideration. United Cities responded to the Consumer Advocate's Reply on February 5, 1999.

In its Petition for Reconsideration, the United Cities requested the Authority to reconsider its decision not to accept the recommendation of the independent consultant, Frank Creamer, to increase the earnings cap of the gas procurement mechanism from

\$25,000 per month (or \$300,000 per year) to an annual cap of \$600,000 for the second year of the PBR mechanism. United Cities asserted that it is unfair to the Company to prevent it from realizing the cap of \$600,000 because of a procedural error committed by the Tennessee Public Service Commission (hereafter "TPSC").<sup>1</sup> Further, United Cities contended that the Authority is mistaken in asserting that such a modification could be construed as retroactive ratemaking.

In Paragraph Two of its Petition, United Cities couched its legal issue for reconsideration in the following manner:

Whether the March 5, 1997 order from the Court of Appeals, that remanded the TPSC's May 3, 1996 order to the TRA for further consideration because of a procedural error made by the TPSC, prevents the TRA from authorizing the increase of the cap from the effective date of the May 3, 1996 order.

United Cities relies solely on a decision from the Florida Supreme Court, *Village of North Palm Beach v. Mason et al.*, 188 So2d 778 (1966), for its assertion that Tennessee Court of Appeals' decision reversing the TPSC's Order of May 3, 1996, does not prevent the Authority from increasing the cap from \$300,000 to \$600,000 as ordered by the TPSC.

United Cities' argument fails on two grounds. First, the case of *Village of North Palm Beach v. Mason* does not support United Cities' proposition that the TPSC's May 3, 1996 Order remained effective after being vacated by the Court of Appeals. Second, United

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<sup>1</sup> On May 3, 1996, following a hearing, the TPSC issued an order modifying the PBR mechanism in accordance with the report of the independent consultant. The modifications ordered by the TPSC included increasing the earnings cap from \$25,000 monthly (\$300,000 annually) to \$600,000 annually. The Consumer Advocate filed a petition for review of the TPSC's May 3, 1996, Order in the Tennessee Court of Appeals. On March 5, 1997, the Court of Appeals issued a decision in which it found that the TPSC's action in denying the Consumer Advocate access to all evidence considered by the TPSC and in failing to afford the Consumer Advocate an opportunity to impeach the same by cross-examination constituted a denial of due process. In its March 5, 1997 opinion, the Court vacated the May 3, 1996 Order of the TPSC and remanded the case to the Tennessee Regulatory Authority for further proceedings as it may deem appropriate. The Final Order on Phase

Cities has misconstrued the Florida Supreme Court's "equitable" argument in attempting to apply that Court's decision to the facts in this case by characterizing the TPSC's fundamental error in the earlier proceeding as a "procedural defect." The Florida Supreme Court's opinion reveals that there is little, if any, similarity between a "procedural defect" in the drafting of a Florida Public Utilities Commission order in the *Village of North Palm Beach* case and the violation of "basic principles of fairness"<sup>2</sup> committed by the TPSC in its denial of the Consumer Advocate's right to cross-examine a witness and to impeach material evidence during the contested case hearing in the earlier proceeding.

Further, the record in this case demonstrated that during the first year of the experimental plan (April 1, 1995 through March 31, 1996), when the cap was set at \$25,000 per month, the Company reached the cap in eight months of the twelve-month period. The Company's share of gains and losses in the first year was approximately \$567,000 from the gas procurement mechanism alone.<sup>3</sup> Mr. Creamer recommended raising the cap to \$600,000 upon recognizing that the gas purchase procurement mechanism alone could generate approximately \$600,000 as the Company's share. His rationale for increasing the cap for the second year of the experimental period was that the earnings cap of \$25,000 acted as a "limiter" on those incentives that would encourage United Cities to participate in the other available incentive mechanisms.<sup>4</sup>

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One issued by the Authority on January 14, 1999, in this docket, culminated from the Authority's proceedings that were conducted in compliance with the remand of the Court of Appeals.

<sup>2</sup> See, *Tennessee Consumer Advocate Division v. T.R.A. et al*, Court of Appeals, Middle District, No. 01A01-9606-BC-00286, March 5, 1997, page 6.

<sup>3</sup> United Cities Gas Company Second Year Review of Experimental Performance-based Ratemaking Mechanism as issued on February 28, 1997, by Andersen Consulting LLP, section entitled "Prior Period" on page 12.

<sup>4</sup> United Cities Gas Company Review of Experimental Performance-based Ratemaking Mechanism as issued on February 2, 1996, by Andersen Consulting LLP page 12.

On closer examination, the Authority found that a substantial amount of the \$567,000 derived from the gas procurement mechanism in the first year of the PBR mechanism was due to the inclusion of the NORA contract and the fact the Company was utilizing a transaction by transaction method of computing the gains and losses. The Directors voted unanimously during their Phase One deliberations that because the NORA contract predated the PBR mechanism, it should not have been included in the PBR Mechanism and, therefore, would be excluded from the computation of the second year gains and losses. The Directors also determined that the transaction by transaction computation was an inequitable method of computing the gains and losses from the gas procurement mechanism and, therefore, ordered the Company to change its method of computation of gains and losses for the second year to a monthly basis.

Based on the Authority's decisions in Phase One, and on subsequent calculations as if these two modifications had been in effect during the first year of the experimental plan, United Cities would have earned approximately \$144,800 in incentive earnings from the gas procurement mechanism and would have reached the \$25,000 monthly cap in only two of the twelve months. Therefore, Mr. Creamer's assertion that the \$300,000 cap served as a "limiter," which arguably was the basis for the TPSC's approval of the second year of the experimental plan, would no longer serve as a reasonable argument in support of reconsideration of the Phase One order in this matter.

Moreover, United Cities contended in its Petition that the Authority was mistaken in its assertion that such a modification could raise an issue of retroactive ratemaking.


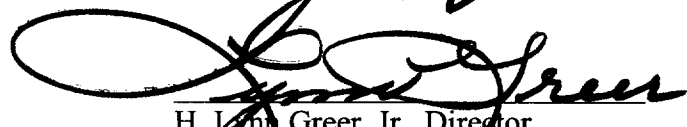

Nonetheless, United Cities did not present any statutory or case law authority in support of its position.

Based upon the foregoing, the Directors voted unanimously to deny United Cities' Petition for Reconsideration.

**IT IS THEREFORE ORDERED THAT:**

1. The Petition for Reconsideration of the Authority's Final Order on Phase One filed by the United Cities Gas is denied.

2. Any Party aggrieved by the Authority's decision in this matter has the right of judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle District, within sixty (60) days of the date of this Order.

  
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Melvin J. Malone, Chairman  
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H. Lynn Greer, Jr., Director  
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Sara Kyle, Director

ATTEST:

  
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K. David Waddell, Executive Secretary